discount offer made by Holiday by MCI."[14] While the Commission initially found this Tariff unlawful as a result of the record developed in its investigation (MCI's offer to Holiday was found to be generally available), it upheld the competitive necessity doctrine and did not conclude on the legality of the Tariff under the initial circumstance i.e., as a direct response to an off-tariff bid by a competitor. Tariff 15 has since had a "tortured legal history."[15]

40. The industry trends underlying the establishment of, and controversy behind, Tariff 12 and 15 (e.g., increasing competition, advancing technologies, and customer demands for turnkey and complex solutions) ultimately prompted "an in-depth examination of the state of competition in the interstate long-distance marketplace today, and of the efficacy of our current regulatory framework in light of this competition."[16] In the resulting Interexchange

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13 Memorandum Opinion and Order, *In the Matter of AT&T Communications; Tariff FCC No. 15*, FCC CC Docket No. 88-471, Released: November 8, 1989, ¶ 1.

14 Id.

15 Anita Taff, "AT&T Files Third Contract Deal and a New Tariff 15," *Network World*, March 16, 1992.

16 Notice of Proposed Rulemaking, *In the Matter of Competition in the Interstate Interexchange Marketplace*, FCC CC Docket No. 90-132, Released: April 13, 1990 (Interexchange Competition NPRM), ¶ 2.

Competition Order, the Commission found that while the long-distance marketplace "is not perfectly competitive,"[17] there was sufficient competition for business services to find that IXCs, including AT&T, "should be permitted to offer services pursuant to individually negotiated customer contracts that are generally available to other similarly situated customers."[18] The Commission explicitly concluded that "permitting AT&T to offer contract rates for services subject to further streamlining is in the public interest"[19] and that "allowing AT&T greater freedom to enter into contracts with customers for these business services will benefit consumers."[20]

41. The benefits to customers were anticipated and explored in the Commission's Notice of Proposed Rulemaking in this matter. The Commission in effect summarized many of the beneficial uses of contracts even where one of the parties was the still dominant AT&T. Contracts: 1) permit the matching of services to customer needs in specific ways, 2) enable users to share cost savings that IXCs would enjoy, 3)

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17 Interexchange Competition Order (1991), ¶ 8.

18 Id.

19 Id., ¶ 102.

facilitate planning through long term commitments and price protections, 4) permit the realization of economic efficiencies and 5) allow IXCs to keep business they might otherwise lose to a competitor.[21] In the Interexchange Competition Order, the Commission concluded:

> "Limiting AT&T to "plain vanilla" generic tariffs, on the other hand, would substantially restrict the availability of these types of service arrangements because no single tariff can adequately incorporate all of the individually designed variables that customers desire. Moreover, because the individually negotiated contract arrangements must be made generally available to other similarly situated customers, other customers can reap the benefits of these new, more specialized arrangements. Of course, to the extent that large customers are able to obtain better or cheaper telecommunications service, their cost of production decreases, which exerts downward pressure on their product prices, to the benefit of all consumers."[22]

42. As the analysis I detailed in the first part of this affidavit makes obvious, I not only agree with these

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20 Id.

21 Interexchange Competition NPRM (1990), ¶ 128.

comments, but also would apply them to all contracts that involve price or other mutually agreed upon terms and not just contracts of the specific nature the Commission was addressing.

B. Safeguards against anti-competitive action by AT&T

43. Commenters in these proceedings granting AT&T contracting authority raised fears that AT&T would be able to discriminate or otherwise act anti-competitively against its competitors. Indeed, the Commission was "cognizant that AT&T is still by far the largest IXC and that it may have certain advantages in the marketplace by virtue of this fact."[23] However, the Commission found it unlikely that AT&T could engage in predatory pricing[24] and sided with the "majority view among courts" that "above-cost prices are presumptively not predatory."[25] The Commission also remained unconvinced that contracting presented an undue risk of discrimination, and cited two simple, but powerful safeguards. First, AT&T had to make the terms and

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[22] Interexchange Competition Order (1991), ¶ 104.

[23] Id., ¶ 36.

[24] Id., ¶ 108 (n171)

conditions of its contracts public and generally available, and second, adequate competition existed to prevent AT&T from raising prices for end users and otherwise discriminating against their customers or competitors.[26]

44. In short, the Commission relied on a combination of contract tariff conditions, resale requirements, and competition to safeguard against any risks presented by relaxing the tariffing regulation of AT&T. The law clearly stated that contracts had to be nondiscriminatory and available to all similarly situated customers, and the Commission retained full authority "to investigate on our own and find unlawful any tariff that does not comply with the [Communications] Act"[27] and to "adjudicate in the complaint process claims of unlawful actions by AT&T."[28] As for competition, the "competitiveness of the business services market" insured that "[u]nlawful tariffs should be rare, and in those few instances in which they may occur,

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25 Id., ¶ 109.

26 Id., ¶ 112.

27 Id., ¶ 75 (n125)

28 Id., ¶ 74.

remedial action can be taken after the tariffs become effective."[29]

45. What fears that commenters might have been able to throw in the face of carrier contracting were far outweighed by the public benefits and competitive necessity of this standard, marketplace activity. In discussing the possible anticompetitive risks posed by carrier contracting by AT&T, the Commission stated:

> "In any case, we find that the public interest would not be well-served by denying all customers the ability to seek individually negotiated contract terms from AT&T in order to eliminate any possible increased risk. Rather, we agree with DOJ that in light of the substantial benefits of contract carriage, such would be a very expensive form of insurance."[30]

The very same line of reasoning applies to the contract pricing of interstate access services by ILECs.

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29 Id., ¶ 73.

30 Id., ¶ 111.

C. Tariff 12, and AT&T contract tariffs have been used extensively

46. Since the Interexchange Competition Order, contract tariffs (e.g., those resulting from individually negotiated contracts) have become the most frequently used method for AT&T to create custom arrangements. By December 1995, there were 175 Tariff 12 options and 3,357 contract tariffs filed.[31] Up to the present, there have been approximately 7,185 AT&T contract tariffs filed.[32]

47. Contract tariffs generally can be characterized by a mix of popular business services, long term commitments, volume discounts, and minimum charge commitments. They incorporate existing services and their underlying tariffs, and then eliminate and/or add details according to customer specifications to make a new "service" complete with its own tariff. They typically incorporate the AT&T services

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31 Richard Hoe, "Benchmarks for AT&T Contract Tariffs," *Business Communications Review*, May 1996.

32 Tariff Transmittal Public Reference Log for Non-Dominant Carriers, FCC, August 22, 1997.

Megacom outbound, 800 Service inbound, Software Defined Network services for data, and private lines.[33]

1. Customer Benefits under Contracts

48. The term, volume and minimum charge commitments have allowed both customers and AT&T to benefit from reduced uncertainty and lower costs. In a study of 500 consecutively filed AT&T contract tariffs published in the *Business Communications Review*, 85% of the contracts had a term limit of 3 years or more,[34] a significantly long horizon in telecommunications. As one would expect, the study also revealed a positive relationship between minimum charge commitments and the sizes of the discounts for services typically included in contract tariffs. Table 2 replicates part of the study's findings and clearly illustrates the willingness of a firm to accept a smaller margin on a product in exchange for greater guaranteed cash flow.

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[33] Richard Hoe, supra n. 31.

[34] Id., Table 2.

Table 1: Minimum Charge Commitments and Discounts for Switched Services Contained in AT&T Contract Tariffs
(Contract Tariff Nos. 2095-2604)

Minimum Revenue Commitment (000)	Average Discount
UniPlan (monthly min)	
$0 - $10	36.9%
$11 - $20	38.7%
$21 - $45	40.4%
$46 - $69	43.8%
$70 - $99	45.5%
$100 - $115	43.7%
$116 - $150	47.8%
$151 - $199	47.3%
$200+	50.7%
SDN (annual min)	
$240 - $500	8.5%
$501 - $800	9.9%
$801 - $1,100	10.3%
$1,101 - $1,500	12.0%
$1,501 - $2,000	11.1%
$2,001 - $2,900	13.1%
800 Svcs (annual min)	
$0 - $400	9.4%
$401 - $750	10.7%
$751 - $1,000	12.4%
$1,001 - $2,000	13.9%
$2,000+	16.2%

Source: Richard Hoe, "Benchmarks for AT&T Contract Tariffs, *Business Communications Review*, May 1997, Table 4a.

49. From an economist's perspective, the structure of the terms and contract price matter less than the fact that they were arrived at through negotiation or a competitive process and that there were beneficial but no ill effects on

customers or the marketplace. In a study of the first 31 Tariff 12 options for the largest business customers, *Business Communications* found that "large revenue deals clearly have per-unit advantages over smaller deals," although "there appears to be no mathematical correlation between a deal's total revenues and its per-minute cost."[35] Among these largest contracts, the lowest per-unit prices are "won by companies that drive the hardest - or at least the shrewdest - bargains."[36] This type of result is exactly what one would anticipate in a customer driven marketplace. There are clearly a number of different expectations that are brought to the negotiating table. Network management levels, service guarantees, custom billing arrangements, rate guarantees and indexing, and the incorporation of new services are just a few of the differentiating variables in these Tariffs and, of course, could include any other customer-supplier negotiated arrangement.

50. Overall, it is likely that there were sizable benefits realized by allowing AT&T to structure contracts

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[35] Paul Strauss, supra n. 10.

[36] Id., p. 99.

individually with customers.[37] Clearly the large businesses which negotiated these contracts benefited; the first companies which were able to reach Tariff 12 VTNS contracts with AT&T saved "on the order of 20 percent to 30 percent over previous expenditures."[38] Resellers and their customers also benefited because they were able to purchase and resell services off of these tariffs, or purchase excess capacity from the original beneficiary of the contract. GE and Hertz, for example, resold capacity under their contracts with AT&T to other resellers and customers.[39] Finally, society benefited from the improved allocation of resources, as reflected in contracts that were determined through the process of negotiation and competitive forces and thus more closely reflected costs.

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[37] "[L]arge users are unanimous in their praise of Tariff 12, and they cite a litany of beneficial contract terms that they have been able to obtain through the Tariff 12 process. They cite, for example, special protection against service outages; front-loading or back-loading of payments to accommodate cash-flow availability or other user concerns; alternative rate structures that might, for example, measure call length in one-second intervals; and escalating annual usage requirements to reflect anticipated growth." Interexchange Competition Order, ¶ 103.

[38] Paul Strauss, supra n. 10, p. 99.

[39] David Rohde, "Firms Hitch Ride on Hertz's Low Tariff 12 Rates," *Network World*, February 28, 1994; "AT&T Rejects Resellers Price Plot Charges; FCC Investigates," *Report on AT&T*, March 14, 1994.

51. These benefits had gone unrealized for years because AT&T had been artificially restrained from negotiating with its customers and participating in competitive bidding situations. Public policy couched in dominant and non-dominant determinations erected these restrictive regulations; in the end, though, competitive necessity - the need to recognize the requirements of individual customers - mandated their withdrawal. Additional benefits to customers were possible because the competitive landscaped had changed. Like the market for access in business areas today, the demands to satisfy individual customer needs and competition for these customers were intense. The cost savings and attainable reductions in uncertainty that could be gained through term and volume commitments necessitated the ability to meet individual customer requirements.

52. In short, where customer needs and competitive forces can determine the terms and conditions of a service, while at the same time safeguarding against abuse of any market power that the incumbent or dominant firm might possess, they should be relied upon. Regardless of their resulting savings to large customers, each Tariff 12 option and contract tariff represents a "win" for the marketplace because they were negotiated between supplier and customer often including a competitive process. And as I describe below, AT&T was not able to use its ability to price services under tariff in a way that injured competition.

2. There have been no significant ill effects from AT&T Contracts

53. As I discuss above, firms have no incentive to price below their generally available tariffs unless there are new mutual benefits that can be shared or competitive pressures to do so. These facts are certainly borne out in the experience under AT&T contracting. While analysts note that one of the keys to securing a good deal with AT&T is negotiating leverage (i.e., the potential for future business or a "win-back" from a competitor),[40] there is absolutely no indication that the company was able to use contract pricing in predatory (e.g., below cost) fashion or in any other way that was harmful to competition in the long distance marketplace. One only needs to look at the oft cited decline in AT&T's marketshare (from 65% of the total toll service revenues in 1990 to 53% in 1995)[41] to conclude that the firm has not been able to use its contracting authority to foreclose competition.

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40 Richard Hoe, supra n. 31; Paul Strauss, supra n. 10, p. 109.

41 "Long Distance Market Shares Fourth Quarter 1996," Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, March 1997, Table 5.

54. Still, several of AT&T's competitors have challenged (sometimes successfully) AT&T's contracting authority, as the long history of Tariff 12, contract tariffs, AT&T's dominance classification and the recent detariffing order bear out. However, the alleged abuses of contracting by AT&T have had no apparent impact on the continuing development of competition in long distance service for the largest businesses. Indeed, increased contract pricing by AT&T has coincided with increased competition for business customers.

55. Most disconcerting of the alleged misconduct by AT&T is the company's apparent failure to furnish services to third parties under selected contracts. Several resellers have filed complaints at this Commission to this effect and some have brought lawsuits against AT&T. While there may well be some instances where AT&T did not willing resell its services, resellers have had full recourse to this Commission and the courts to resolve these disputes. In fact, several have been settled and resellers are now providing service under the contracts.[42] To the extent

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[42] David Rohde, "Tariff 12 Ruling May Save Users Money," *Network World*, June 12, 1995, p. 17; "AT&T Settles One Reseller Complaint, Loses Court Case Over Another," *Common Carrier Week*, July 4, 1994; "AT&T Settles Dispute Over False Contract," *Communications Today*, October 29, 1996.

there have been problems with AT&T reselling its services, the problems have stemmed from AT&T's behavior toward resellers, not from the ability to contract price.

56. Even with hindsight, these reseller complaints do not undermine the Commission's initial conclusion in the Interexchange Competition Order that it was "not reasonable to assume that AT&T will refuse to present them [resellers] with viable service options at reasonable rates."[43] The basis of this conclusion is a sound one which remains true today: contracts must be "made available to all similarly situated customers, including resellers."[44]

57. In spite of the complaints leveled against AT&T, the Commission's policy on dominant carrier contracting has not hindered and has probably advanced the telecommunications resale industry. Long distance resellers nationwide number over one thousand, and represented $11.6 billion of the total switched services market in 1995.[45] According to the

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43 Interexchange Competition Order, ¶ 115.

44 <u>Id</u>.

45 Atlantic*ACM as reported by the Telecommunications Resellers Association. "Telecom Resale Industry Facts & Figures," >>www.tra-dc.org<<, downloaded Aug. 20, 1997.

Atlantic*ACM consultancy, revenues from resold long distance grew at a CAGR of 31 percent between 1993 and 1995.[46] Pure switchless resellers, as a subset of long distance resellers, represented 3 percent or $2 billion of the total long distance market in 1994 and are expected to represent 6 percent of the market in the year 2000.[47]

58. The success of resellers is due in large part to the changing competitive dynamics in the long distance marketplace that necessitated the granting of AT&T contracting authority in the first place. As large customers increasingly sought complex, network-level solutions to their communications needs, AT&T had to develop new products[48] that were price-competitive with those being offered by the fast-growing competitors like MCI, Sprint and WilTel (now Worldcom).[49] Through newly gained contracting

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46 Id.

47 Frost & Sullivan as reported by the Telecommunications Resellers Association. "Telecom Resale Industry Facts & Figures," >>www.tra-dc.org<<, downloaded Aug. 20, 1997.

48 An example would be Software Defined Networks (SDN).

49 It should be noted that one of the reasons these companies were growing so fast is because, like CLECs today, they were able to target high revenue business customers with individualized terms and conditions which AT&T as a dominant carrier could not offer.

freedom, AT&T was able to negotiate individual customer arrangements for these services. Since the resulting tariffs were generally available, resellers could "hop" on the tariffs, and take advantage of the discounts for term, volume and minimum charge commitments by aggregating or reselling usage. Furthermore, since the facilities-based competitors were all building out additional capacity to compete for large user business, they (including AT&T) were compelled (e.g., they had excess capacity on their networks) to compete for the very resellers who were competing against them elsewhere in the marketplace.[50] Resellers, then, not only benefited immediately from the introduction of AT&T contract tariffing, but also helped fuel further price competitive and/or service competitive developments in the industry.

59. AT&T's Tariff 12 options and contract tariffs have continued to play an important role in the viability of long distance resellers, and resellers have continued to increase the competitiveness of the long distance marketplace. The

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[50] For example, Sprint's 1995 resale program ("Resale Solutions") set up wholesale prices that were not tied to other tariffs so that its resellers and their end users would be isolated "from the repeated price hikes and changes in terms that have recently characterized major carrier tariffs." See David Rhode, "Sprint Offers Price Protection on Resale," *Network World*, September 18, 1995, p. 17.

importance of AT&T contract pricing was most recently reiterated in the non-dominance proceeding. Opponents to AT&T reclassifications prompted the carrier to "commit to retain terms or rates on its most heavily resold services and contract tariffs for at least one year and to honor reseller requests for new or additional services in a timely manner."[51] The Commission, for its part, has consistently applied its "long-standing policies of prohibiting restrictions on resale and barring restrictive eligibility requirements"[52] - both in the interexchange marketplace and more recently with respect to local services.

60. In sum, there have been no lasting ill effects from AT&T contracting. There is no evidence that AT&T, as a dominant carrier, was able to foreclose competition through below-tariff pricing for some services. While the several reseller complaints may reflect bully tactics in some situations, they are being handled by the laws and regulations governing contracting. Despite these complaints

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51 Victor Toth, "AT&T Declassified - Bureaucrats Still Dominant," *Business Communications Review*, January 1996.

52 Order on Reconsideration, *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended,* FCC CC Docket No. 96-61, Released: August 20, 1997, ¶ 75.

and apparent misconduct by AT&T, resellers have obtained carrier services and have grown impressively during the 1990s.

61. Moreover, the Commission weighed these potential risks and in effect determined that they were outweighed by competitive necessity. The Commission has had further opportunity to examine and rectify any ill effects of carrier contracting during the recent detariffing proceeding. Instead of re-imposing carrier prohibitions on contracting, however, the Commission settled on a policy of complete detariffing (i.e., not allowing nondominant interexchange carriers - AT&T is now nondominant - to file tariffs), and stated that "[w]e seek ultimately to accomplish the same result in every telecommunications market, because we believe that effectively competitive markets produce maximum benefits for consumers, carriers and the nation's economy."[53]

62. Clearly, if competitive necessity mandated the Commission to authorize AT&T to provide services on customer specific terms and conditions, the experience under AT&T

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53 Second Report and Order, *In the Matter of Polity and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the*

contracting illustrates the "release" of competitive benefits that were anticipated from the competitive necessity in the first place. Although it is not realistically possible to quantify the extent of reduced cost for AT&T, a large number of its customers and competitors have benefited from their ability to enter customer specific agreements - more than 7,000 contract tariffs and 150 Tariff 12 Options. The consistent growth of switch-based and switchless resellers also speaks to the extent of the gains. In addition, contract pricing has helped resellers carve out an important role in the marketplace in which AT&T competes with other facilities-based carriers and resellers for both end users and resellers alike. I anticipate a similar release of benefits to customers following ILEC contracting for interstate access services.

V. Conclusion and Recommendation

63. It is time to allow ILECs to enter into contracts for their interstate access services. Every day that passes without ILECs having this authority means another day of reduced economic efficiency, higher than necessary prices for some customers, and less competition for those

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Communications Act of 1934, as amended, FCC CC Docket customers. These losses and inefficiencies are deadweight losses and can not be recouped by future Commission action. While the benefits from allowing contracts for access services are being foregone, no counterbalancing benefits are accruing from competitive protection.

64. The analysis I have presented in this affidavit makes it clear that there are abundant reasons for allowing contracts. There is substantial and rapidly growing competition for access customers. Where such competition prevails, as it does in the case of access services, contracting should be allowed. Resale and the potential for facilities-based alternative offerings make it doubly unnecessary to prevent the allowance of contracts for access services.

65. The reasons for allowing contracts for access services are convincing in and of themselves. However, the fact that the Commission has been down this road before and has allowed AT&T, as a dominant provider of services, to utilize this efficient tool makes the case even stronger. The experience with AT&T was that there were benefits without attendant harms. We can expect a similar result in the case of the incumbent LECs.

No. 96-61, Released: October 31, 1996, ¶ 4.

66. I recommend that the Commission permit incumbent LECs who are classified as dominant to enter contracts for their interstate access services. Doing so would be a recognition of economic realities - efficiency gains that can be achieved and the changed marketplace in which the incumbent LECs participate. Inasmuch as the losses to society and the market players are compounding daily, I strongly encourage the Commission to allow ILECs the freedom to contract.

STATE OF CALIFORNIA)
) SS: AFFIDAVIT OF ROBERT G. HARRIS
EMERYVILLE)

ROBERT G. HARRIS, of lawful age, first duly sworn deposes and says:

1. I am a Principal at Law and Economics Consulting Group located in Emeryville, California, and have caused to be prepared written testimony relative to U S WEST Communications Group, Inc.

2. Such transmittal is true and correct as I verily believe.

Further affiant sayeth not.

Robert G. Harris

Robert G. Harris

Subscribed and sworn to before me this 27th day of August, 1997.

ANDREW W. SHALABY
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Notary Public

Attachment 1

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